



Corporation Tax Audit Manual

PA Department of Revenue

Bureau of Audits



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Introduction

The primary objective of this manual is to provide instructions on the performance of a Pennsylvania corporation tax compliance audit. Instructions are based on state tax statutes, department regulations, court cases, departmental policies, previous audits, appeal decisions, and general accounting and auditing principles at the time of this publication.

This manual is intended as guidance to the audit staff. Auditing methods and techniques suggested in the manual may not be necessary or applicable for every audit. This manual is not authoritative and may neither be cited to support an audit position nor relied on by the taxpayer. This manual and its auditing procedures will be continuously evolving as it is impacted by changes in tax statutes, regulations, court cases and departmental policies.



Pennsylvania Corporate Net Income (CNI) Tax

- A. Checkpoint – Is a subscription-based tax reference guide provided by Thompson Reuters. If you do not have access reach out to your PC Coordinator.
1. Navigating Pennsylvania Statutes, select Table of Contents / State Tax Library / State Tax Reporter / State / Pennsylvania / Statutes / Pa. Stat. Ann. / Title 72 TAXATION AND FISCAL AFFAIRS / Chapter 5 TAX REFORM CODE OF 1971 / Article IV Corporate Net Income Tax
 2. Range of Statutory Guidance - 72 P.S. § 7401 through 72 P.S. § 7412
 3. Navigating Pennsylvania Regulations, select Table of Contents / State Tax Library / State Tax Reporter / State / Pennsylvania / Regulations / Pa. Code / Title 61 REVENUE / Part I DEPARTMENT OF REVENUE / Subpart B General Fund Revenues / Article VI Corporation taxes / Chapter 153 Corporate Net Income Tax
 4. Range of Regulatory Guidance - 61 PA. CODE § 153.1 through 61 PA. CODE § 153.81
- B. Tax Rate – Corporate Net Income Tax is a tax imposed on corporations at a rate of 9.99%
- C. Federal Taxable Income (Statutory Guidance - 72 P.S. § 7401.(3)1.(a))
1. Line 28 – As reported on the federal income tax return (FF1120) or equivalent line of the FF1120A, FF1120S, FF1120RIC or FF1120REIT.
 - a. If the taxpayer is part of a consolidated group, a pro-forma federal return must be filed on a separate company basis. The amounts from the pro-forma federal return should match to the separate company breakdown of the consolidated schedules.
 - b. If the taxpayer has filed a Report of Change (RCT-128) during the course of the audit, any reported adjustments to federal taxable income must be analyzed. System processing of the RCT-128 will determine if the starting point will change from the original filing.
 2. Charitable Contribution Expense – Is limited to 10% of the taxable income without regard to charitable contributions (Regulatory Guidance - 61 Pa. Code § 153.14.(2))
 - a. It is calculated as (federal taxable income plus charitable contribution expense) * 10%. Excess contributions can be carried forward five years.
 - b. Use FF1120 Income Analysis on the 1120 Add Edit Form in TaxMaster to aid in calculating any excess contributions.
 - c. For a year where there is a loss, the contribution loses its characteristics and becomes part of the federal net operating loss deduction. Therefore, there is no charitable contribution deduction to be carried forward.
 3. Capital Losses – Are allowed to the extent of capital gains on Federal Schedule D. FF1120, Line 8 should not be less than zero. Excess contributions must be carried back three years then carried forward five years. (Statutory Guidance - 72 P.S. § 7401(3)1.(a))
 - a. The taxpayer must provide the FF 1139 along with the prior years' Federal Schedule D.



- b. Use FF1120 Income Analysis on the 1120 Add Edit Form in TaxMaster to aid in calculating capital loss adjustments.
 - c. The taxpayer must file Reports of Change for the years affected by the carryback
 - d. The carryback must start with the oldest applicable year (Example: A 2015 carryback would start with the 2012 tax year)
4. Sham Transaction Adjustments
- a. The Department has the authority to employ the sham transaction doctrine which gives the Secretary the authority 'to disregard, for taxing purposes, transactions that have no economic substance or business purpose other than tax avoidance.' (Statutory Guidance - 72 P.S. § 7401(3)(1))
 - b. Intercompany transactions incongruent with ordinary and usual expenses
 - i. Separate Company Pro-Forma FF1120
 - 1) Royalty or Interest Income
 - 2) Interest Expense
 - 3) Other Income – Service Fees, Royalty, Interest, Management Fee, Miscellaneous, Intercompany
 - 4) Other Deductions – Royalty, Interest, Miscellaneous, Intercompany, Factoring, Administrative
 - 5) Cost of Goods Sold (Other Costs) – Royalty, Interest, Miscellaneous, Intercompany, Factoring, Administrative
 - 6) Balance Sheet (Intercompany Accounts) – Notes Receivable, Loans Payable, Other Current Assets, Other Assets, Other Investments, Other Current Liabilities, Other Liabilities,
 - 7) Schedule M-3 – Review for intercompany items
 - 8) Schedule 8916-A - Review for intercompany items
 - ii. Consolidated FF1120
 - 1) Verify the taxpayer's separate company column matches the pro-forma
 - 2) Verify taxpayer's affiliated entities from FF851, organizational chart, etc.
 - 3) Verify what transactions are being reported as eliminations. For instance, royalty and interest income and expense, or intercompany assets and liabilities
 - iii. Year-to-Year Comparison (3 to 5 years)
 - 1) Analyze the following accounts to determine if any large inconsistencies exist - total sales, COGS, other income, interest expense, other deductions, amortization expense, taxable income, assets, liabilities
 - 2) Analyze for items of income or expense that seem out of the ordinary. Example: Service provider with large COGS deduction



- c. Additional Information to be Requested
 - i. Question any of the above transactions if they seem out of the ordinary or are not easily identifiable. Request a detailed breakdown of each item.
 - ii. Transfer Pricing Study and a detailed list of all intellectual property, if applicable. The Transfer Pricing Study must be current and inclusive of the covered transactions being questioned. Note that per the federal regulations a Transfer Pricing Study cannot be applied retroactively. This includes a prohibition on taxpayers adjusting or correcting their Transfer Pricing on timely filed amended FF1120X's.
 - iii. If any explanations indicate the presence of intercompany transactions provide an applicable request for financial records to the taxpayer
 - iv. Once the taxpayer responds to the record request, determine if further detail is required
 - d. The five areas of analysis are:
 - i. Review – determine the presence of intellectual property by reviewing assignment and licensing agreements. Is the intellectual property live or dead, per the US Office of Patents and Trademarks
 - ii. Royalty Rate – determine if the transaction is supported by the Transfer Pricing Study.
 - iii. Money Flow – determine if there is actual cash flow vs. bookkeeping entry.
 - iv. Day-to-Day Operations – Verify the business location, employment records, checking account, attorney fees, who makes the decisions, etc.
 - v. Board Directors' action – Verify the board minutes, how IP is managed and maintained, etc.
 - e. How to adjust (determine if addback provision applies or if it is a sham)
 - i. If the transaction truly involves intangible expenses, the adjustment must be reported as an IE addback in the Statutory Addition section of the CNI tax calculation (see section I.E.4). The taxpayer may claim an exception for the addback by filing the REV-802 with the auditor.
 - ii. If documentation is not provided by the taxpayer or you cannot determine business purpose other than tax avoidance, the transaction may be considered a sham and is reported as an adjustment to the federal taxable income. The adjustment is shown on the 1120 Income Analysis as a miscellaneous adjustment to line 28.
5. Gain/Loss Sale Subsidiary Stock
- a. Gains or losses included in Federal taxable income from the sale of subsidiary's stock attributed to excess losses or accumulated earnings and profits used for consolidated purposes per Treas. Reg. § 1.1502 (1996) are not recognized on a separate company basis.
 - b. If not included in tax return filed request a breakdown of how gain was calculated, showing the reduction in basis of stock for NOLs used by parent.



- c. Recalculate the gain or loss on sale of stock for PA purposes without the reduction for NOLs used by the parent.
6. Domestic Production Activities Deduction
 - a. Effective for years between January 1, 2005 and December 31, 2017
 - b. Qualifications to claim this deduction are different than the qualifications to claim the Manufacturing, Processing, or Research and Development exemption for the Capital Stock Tax or Foreign Franchise Tax.
 - c. IRC Section 199(d)(4)(c) provides that the deduction shall be allocated among the members of the expanded affiliated group in proportion to each member's respective amount (if any) of qualified production activities income. In calculating PA Taxable Income, a corporate taxpayer is entitled to the same deduction used in the calculation of Federal Taxable Income. However, the deduction claimed by a corporation who is part of a consolidated federal group may not exceed the deduction allocated to that corporation pursuant to IRC Section 199(d)(4)(c). (Revenue answer to question 13 - PICPA Question and Answer - September 28, 2005.)
 7. Calculation of Taxable Income Federal S Corporations not a PA S-Corp (Statutory Guidance - 72 P.S. § 7401(3)1.(p))
 - a. The taxpayer may opt out from being treated as a PA S-Corp by filing PA form REV-976 - Election not to be Taxed as a Pennsylvania S Corporation
 - b. Additions from Schedule K of FF 1120S unless otherwise noted:
 - i. Net real estate rental income.
 - ii. Other net rental income.
 - iii. Interest.
 - iv. Ordinary dividends.
 - v. Royalties.
 - vi. Other portfolio income.
 - vii. Gain (net of capital gains + Sect. 1231 gain against capital losses). Should not be less than zero.
 - viii. Sect. 1231 (if a loss it is considered an ordinary loss-include in the calculation of taxable income, if a gain it is considered a capital gain, include the amount with capital gains and net against capital losses).
 - ix. Other income.
 - c. Deductions from Schedule K of FF 1120S unless otherwise noted:
 - i. Deductions related to portfolio income.
 - ii. Other deductions.
 - iii. Interest expense on investment debts.
 - iv. Total foreign taxes paid.
 - v. Total expenditures to which section 59(e) election may apply.
 - vi. Domestic production activities deduction IRC section 199.



d. Total = total net income before section 179 & charitable contributions.

8. Extraterritorial Income Deduction

- a. Reported as either other deduction or other expense on the federal income tax return.
- b. Included in the calculation of federal taxable income.
- c. No statutory provision to add back this item when calculating PA taxable income.
- d. Additional details on extraterritorial income can be found on the instructions for federal form 8873.

D. Statutory Deductions

1. Dividends – Domestic dividends are deductible to the same extent as allowed to arrive at the federal dividend deduction. Certain foreign dividends are also deductible for Pennsylvania purposes. The taxpayer must provide PA Schedule C-2 (Statutory Guidance - 72 P.S. § 7401(3)1.(b))

- a. For tax periods beginning prior to January 1, 2018 - The amount of dividend deduction allowed is based on the percentage of ownership
 - i. 100% dividend deduction for sum of total deductions on Federal Schedule C
 - ii. 100% dividend deduction for foreign dividend gross-up
 - iii. 70% dividend deduction for less than 20 percent owned foreign corporation
 - iv. 80% dividend deduction for greater than or equal to 20 percent owned foreign corporation
 - v. 100% dividend deduction for foreign corporations that meets the 80 percent voting and value test
- b. For tax periods beginning on or after January 1, 2018 - The amount of dividend deduction allowed is based on the percentage of ownership
 - i. 100% dividend deduction for sum of total deductions on Federal Schedule C
 - ii. 100% dividend deduction for foreign dividend gross-up
 - iii. 50% dividend deduction for less than 20 percent owned foreign corporation
 - iv. 65% dividend deduction for greater than or equal to 20 percent owned foreign corporation
 - v. 100% dividend deduction for foreign corporations that meets the 80 percent voting and value test
 - vi. 100% dividend deduction for Foreign-Derived Intangible Income (FDII) and Global Intangible Low-Taxed Income (GILTI) per FF 8993. See Corporation Tax Bulletin 2019-02
- c. Repatriation Transition Tax (RTT) is a one-time deduction on untaxed earnings of foreign corporations accumulated prior to 2018. For tax periods beginning in 2017 only (For additional guidance refer to Information Notice 2018-01)



- i. REV-798A – PA Schedule RTT must be attached with proper calculation.
 - d. Obtain a detailed schedule of all dividends listing the name and percentage ownership. To allow dividend deduction the taxpayer must be a direct owner of stock of the investee corporation.
2. Interest on US Securities – Is deductible to the extent of the federal treatment of expenses attributable to exempt income from state and local obligations. (Statutory Guidance - 72 P.S. § 7401(3)1.(b.1))
 - a. Interest must be reduced by the following
 - i. Interest on indebtedness incurred to carry security. Prorated by fraction of US & PA securities divided by total assets
 - ii. Expenses incurred in the production of such interest income.
 - iii. Other Expenses deducted on the Federal Income Tax return that would not have been allowed under 26 USC section 265 if the interest were exempt for Federal Income Tax.
 - b. Verify the amount claimed is part of FF1120, Line 5. Obtain a detailed schedule showing the calculation of net interest deduction, which should include a listing of investments that generated the exempt interest income.
 - c. Corporation Tax Bulletin No. 94 lists securities determined to be obligations of the U.S. Government.
 - d. Interest from repurchase agreements is not considered interest from US securities, therefore is not deductible.
3. Current Year Additional PA Depreciation – An adjustment to allow the taxpayer to recover, or deduct, the amount of depreciation previously added back. See Section I.E.3 – Current Year Bonus Depreciation for detail regarding federal information and the addback adjustment for 168(k) bonus depreciation. (Statutory Guidance – 72 P.S. § 7401(3)1.(r)(1) and (2))
 - a. If the taxpayer reported an addition for 168(k) bonus depreciation, they are entitled to take the appropriate deduction.
 - i. Property placed in service prior to 9/28/2017– The 3/7ths fraction is used to recapture bonus depreciation disallowed over the life of an asset
 - ii. Property placed in service on or after 9/28/2017 – The MACRS calculation is used to recapture bonus depreciation disallowed over the life of the asset
 - b. Schedules C-3 and C-4 was used as an ongoing historical reference for all bonus depreciation calculations, used for property placed in service prior to 9/28/2017. See Appendix 1
 - c. Schedule C-8 Adjustment for Bonus Depreciation (REV-1834 page 1) – used to report bonus depreciation adjustments for both depreciation calculations for tax periods 2017 and forward. (Prior to 9/28/2017 and on or after 9/28/2017).



- Line 1* – Balance – unused bonus depreciation from prior year
 - Line 1A* – Unrecovered Balance – unused bonus depreciation from a merger. Taxpayer must include identifying information about the merging entity.
 - Line 2* – Federal Bonus Depreciation
 - Line 2A* – Prior to 9/28/2017 – The addback subject to 3/7ths recovery calculation
 - Line 2B* – On or after 9/28/2017 – The addback subject to the MACRS recovery calculation
 - Line 3* – Addition Calculation 2A plus 2B
 - Line 4* – PA Bonus Depreciation
 - Line 4A* – Prior to 9/28/2017 – The deduction as calculated by prior 3/7ths formula
 - Line 4B* – On or after 9/28/2017 – The deduction as calculated by MACRS
 - Line 5* – Deduction Calculation 4A plus 4B
 - Line 6* – Other Deduction – must be supported by Schedule C-9
 - Line 6A* – Prior to 9/28/2017 – Schedule C-9, Line 2
 - Line 6B* – On or after 9/28/2017 – Schedule C-9, Line 4
 - Line 7* – Other Deduction Calculation 6A plus 6B
 - Line 8* – Total Deduction Calculation 5 plus 7
 - Line 9* – Remaining Balance Calculation 1 plus 1A plus 3 minus 8
- d. Schedule C-9 Deduction for Property which is fully Depreciated, Sold or otherwise Disposed (REV-1834, page 2) – used to report bonus depreciation adjustments for other deductions
- Line 1* – Prior to 9/28/2017
 - Line 1A* – Bonus Depreciation Addback
 - Line 1B* – Total PA Deduction previously claimed
 - Line 2* – Recovery for property placed in service prior to 9/28/2017
 - Line 3* – On or after 9/28/2017
 - Line 3A* – Bonus Depreciation Addback
 - Line 3B* – Total PA Deduction previously claimed
 - Line 4* – Recovery for property placed in service on or after 9/28/2017
- e. Auditor may request a detailed list of all 168(k) property to determine the proper addback. The detail should also include disposition information.
- f. For property placed in service prior to 9/28/2017, verification of the federal depreciation will determine if the 3/7ths calculation is accurate.
- g. For property placed in service on or after 9/28/2017, the auditor will need to verify the MACRS calculation for proper deduction.



- a. Federal 168(k) qualifying property
 - i. New property with a recovery period of 20 years or less.
 - ii. Qualified leasehold improvement property – generally any improvement to the interior of a building that is nonresidential real property.
 - iii. Bonus Depreciation applies after any reduction for a Section 179 allowance.
 - iv. Property amortized under Section 197 does not qualify.

Federal Act	Date Assets Acquired	Federal Deduction	PA Deduction
Job Creation and Worker Assistance Act of 2002	between 9/10/2001 - 9/11/2004	30%	3/7 calculation
Jobs and Growth Act of 2003	after 5/5/2003	30% or 50%	3/7 calculation
Economic Stimulus Act of 2008	between 1/1/2008 - 12/31/2008	50%	3/7 calculation
Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010	between 9/8/2010 - 1/1/2012	50% or 100%	3/7 calculation
Tax Cuts and Jobs Act of 2017	after 9/27/2017	50% or 100%	defer back to MACRS

- b. Pennsylvania has elected not to follow the federal depreciation method as outlined in the above table. Businesses must adjust their depreciation expense when filing their corporate income tax returns. This involves a two-step process.
 - i. Step one: The amount of Federal bonus depreciation must be added back to income. This is the amounts reported on the FF4562, Line 14 and Line 25
 - 1) For assets acquired between 9/8/2010 and 1/1/2012 the Department permitted full recovery of disallowed 100% bonus depreciation in the year that such depreciation was claimed and allowable for federal tax purposes. The net result was that no adjustment was necessary.
 - ii. Step two: Taxpayer is entitled to a deduction
 - 1) For assets placed in service prior to 9/28/2017 – equal to a fraction of 3/7 times the amount of depreciation calculated under normal rules with the remaining basis.
 - 2) For assets placed in service on or after 9/28/2017 – equal to the regular MACRS depreciation calculation.



- iii. If the taxpayer disposes of an asset, or the asset is fully depreciated, prior to the taxpayer recovering all of the disallowed bonus depreciation the taxpayer is allowed to deduct the remaining disallowed depreciation in the last year the asset is depreciated on the federal income tax return.
 - 1) *Adjustment for disposition* must be reported on the proper schedule.
 - 2) *Other Adjustments* is only applicable to assets placed in service prior to 9/28/2017, as the MACRS calculation would not create a balance
 - a. Taxpayer must file the appropriate PA Schedule to show the full depreciation calculation.
 - i. For assets placed in service prior to 9/28/2017 – All data is contained in the REV-799 (C-3 and C-4)
 - ii. For assets placed in service on or after 9/28/2017 – Summary data is reported on the REV-1834 (C-8 and C-9)
 - b. Mergers and Conversions
 - i. In the case of mergers, where the acquired corporation had unrecovered bonus depreciation, the balance is transferred to the survivor.
 - ii. In the case of conversions, where a corporate subsidiary becomes a single member LLC (disregarded entity), the balance is transferred to the owning member corporation
 - c. Verify the addback from the FF4562, lines 14 and 25.
 - d. See external instructions to verify the balance carry-in for the taxpayer and any merged or converted entities, if applicable.
4. Intangible Expense or Related Interest Expense – Act 52 of 2013 requires, for tax years beginning after 12/31/2014, an add-back of intangible expenses to income for interest, royalties, patents, trademarks, etc. between affiliated entities. Taxpayers must complete REV-802, Schedule C-6 to report all intangible expense and claim any applicable exceptions. (Statutory Guidance - 72 P.S. § 7401(3)1.(t))
- a. There are three exception that a taxpayer may claim. See Information Notice Corporation Taxes 2016-1.
 - i. Principle Purpose & Arms-Length - The principal purpose must be a valid business purpose, other than the avoidance of CNI tax. The terms are considered arm's length where the terms of the transaction under consideration are such as would have been arrived at in independent transactions with or between unrelated parties under similar circumstances.
 - ii. Foreign Treaty - an affiliated entity domiciled in a foreign nation which has in force a comprehensive income tax treaty with the United States providing for the allocation of all categories of income subject to taxation.
 - iii. Conduit - the affiliated entity pays expenses to an unaffiliated entity for the same intangible asset.



- b. How to review when the taxpayer has filed the REV-802
 - i. Verify the total intercompany intangible expense and related interest expense from various sections of the FF1120, including but not limited to other deductions, cost of goods sold or other income. The intercompany interest expense should match the FF8916-A, Part III, Line 3a or 3b.
 - ii. If the taxpayer claims the principle purpose/arms-length exception both elements must be substantiated in order for the exception to be approved. Examples of documentation to support the claim for the exceptions include: a contemporaneous business or marketing plan, corporate minutes and memoranda and/or section in the Transfer Pricing Study that shows reasonable projections of the anticipated economic benefits.
 - iii. If the taxpayer claims the foreign treaty exception the auditor must confirm that the US has a foreign treaty with the foreign nation cited. The auditor may also request the FF 5471/5472 to confirm the transaction cited was reported.
 - iv. If the taxpayer claims the conduit exception the auditor should request a copy of the licensing agreement that the affiliated entity has with the outside party to verify that the taxpayer's portion of the intangible expense was properly computed.
- c. How to review if the taxpayer has not filed the REV-802
 - i. If the auditor observes that the return contains intangible expenses and related interest expense with affiliates as explained above, request the following:
 - 1) The Complete Consolidated FF 1120
 - 2) The General Ledger Trial Balance for the Taxpayer
 - 3) The Transfer Pricing Study
 - 4) The Assignment Agreement for the Marks to the affiliated entity
 - 5) The Licensing Agreement between the Affiliated Entity and Taxpayer.
 - 6) The Promissory note between the Taxpayer and the Affiliated Entity for the Intercompany Debt
 - 7) A Written Statement from the Taxpayer explaining the business purpose of the loan
 - 8) Form 10-K "financial notes" sections that deals with indebtedness and mergers
 - ii. Analyze Intangible Expense: Are the royalties paid to a foreign entity or a domestic entity? For foreign - review FF5472. For domestic – does it also file in PA?
 - iii. Analyze Related Interest Expense: Are the royalties paid to a foreign entity or a domestic entity? For foreign - review FF5472. For domestic – does it also file in PA?



- iv. If the transaction does not qualify for the addback, is it a sham transaction, impacting income (Line 28). An example is if the interest expense does not relate to an intangible asset and the transaction lacks economic substance.
 - v. The auditor must provide workpapers to the taxpayer showing the preliminary findings for the intangible expense and related interest expense being added back. The taxpayer may file the REV-802 to claim any exception. See b above to verify the exceptions.
- d. **The following questions are not all inclusive and additional question may be used.** The auditor may use these potential questions when compiling the Request for Financial Records when there may be potential intercompany transactions:
- i. During our audit, we noted that the taxpayer incurred expenses to an affiliate for intangibles assets (e.g., patents, trade names, trademarks, etc.), please answer the questions below:
 - 1) Provide a description of the affiliated entity's general business operations, including types of products sold and/or services provided.
 - 2) Explain the nature of the intangible and how it was created (e.g., taxpayer's research and development).
 - 3) How did the Taxpayer determine the charge or cost for the use of the intangible asset?
 - 4) If a cost study was completed, please provide a copy of the applicable transfer pricing agreement for the tax years subject to audit. Did the taxpayer and the affiliate adhere to the terms of the licensing agreement?
 - 5) Did the taxpayer transfer, sell, contribute, or otherwise transfer intangible property to an affiliate?
 - a) If so, explain the business reasons why the taxpayer or an affiliate transferred the intangible assets to an affiliate. Provide a copy of all other documents drafted in connection with the transfer of intangible assets (e.g., including contracts, assignments, letters, board of director minutes, as well as any licensing agreement or other intercompany transactions).
 - b) Was the transfer of the intangible assets to the affiliate treated as a IRC section 351 transaction, and, if so, what was the value of the intangible property when it was contributed to the affiliate? How did the transferee value the intangible assets?
 - c) Is the affiliate amortizing the intangible asset(s) transferred to the affiliate?
 - 6) Does the taxpayer have one or more royalty expenses that were not specifically identified on the taxpayer's federal income tax return?



- 7) Does the affiliate license the intangible assets to third parties?
- 8) If the taxpayer licenses patents, are the patents registered with the U.S. Office of Patents and Trademarks, if so provide documentation of the registration.
- 9) Provide a full copy of the consolidated federal income tax return that the Taxpayer and the affiliated entity filed under for the audit years, with consolidation schedules.
- 10) Please answer the following questions regarding the affiliate:
 - a) Did the affiliate have employees? If so, please provide a copy of the affiliate's payroll withholding reports.
 - b) Did the affiliate maintain a bank account? If so, did the taxpayer have access to it?
 - c) Explain how the taxpayer compensated the affiliate. In other words, does the taxpayer make a cash payment to the affiliate or is the compensation effectuated through a journal entry.

- ii. Did the taxpayer incur an interest deduction for a loan to an affiliate?
 - 1) If so, provide copies of the loan documents, including promissory notes, loan agreements, security agreements, pledge agreements, including any amendments or modifications thereto.
 - 2) Did the taxpayer and the affiliate adhere to the terms of the loan document agreement?
 - 3) Can you provide proof of payment between the entities such as wire transfers or checks?

5. Other Additions - All other statutory additions must be reported on Schedule OA

- a. Only in 2015, the Intangible Expense or Related Interest Expense should be reported on the other addition line.

F. Non-Business Income or Loss

1. Definitions:

- a. Business Income means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if either the acquisition, the management or the disposition of the property constitutes an integral part of the taxpayer's regular trade or business operations. The term includes all income which is apportionable under the constitution of the United States per 72 P.S. § 7401(3)2.(a)(1)(A).
- b. Nonbusiness income means all income other than business income. The term does not include income which is apportionable under the constitution of the United States per 72 P.S. § 7401(3)2.(a)(1)(D)

2. Filing Requirements – If the taxpayer reports nonbusiness income the REV-934 must be completed. The taxpayer is also required to provide the following information:



- a. A statement providing background information concerning the source of the nonbusiness income and the circumstances surrounding its generation. Include as part of this statement the specific involvement of the taxpayer in the generation of the income.
 - b. A statement explaining why the income is not subject to apportionment under the U.S. Constitution.
 - c. Were any expenses, liabilities, deductions or credits claimed related to any items of nonbusiness income in the current or prior tax years? If yes, please attach a statement that specifies by item of nonbusiness income, the amount of expenses, liabilities, deductions or credit claimed for each year.
 - d. Was income from the same source as any item(s) of nonbusiness income reported above reported by the taxpayer (or a predecessor entity) as apportionable business income on a Pennsylvania Corporate Tax Report, or similar corporate income tax return in another jurisdiction, for this or a prior tax year? If yes, please attach a statement that identifies the year(s) for which it was so reported, the jurisdiction(s) in which it was so reported and provide a written explanation for the change in the treatment of the income from business to nonbusiness.
 - e. Was 100% of the income reported to Pennsylvania as total nonbusiness income allocated to only one other state? If yes, please identify the state and provide a copy of that corporate tax return. If no, please complete Part B in regard to the taxpayer's current tax year. While completing Part B note that all amounts included must be reported net of related expenses.
 - f. Was any of the nonbusiness income reported as unitary income in any other jurisdiction (besides PA)? If so, please provide an explanation and a list of those states where the nonbusiness income was included in unitary income.
3. Information gathered as a result of the taxpayer responding to the questions set forth in the revised REV-934 should be forwarded to the specialist that works with your region for analysis by HQ staff

G. Apportionment –

1. For tax years beginning after December 31, 2012, the weighting is 100% of the sales factor. (Statutory Guidance - 72 P.S. § 7401(3)2.(a)(9)(A)(v))
2. The sales factor is a fraction, calculated to 6 decimal places, the denominator of which is the total sales of the taxpayer with the numerator being the sales of the taxpayer in Pennsylvania. (Statutory Guidance - 72 P.S. § 7401(3)2.(a)(15))
3. Sales means all gross receipts of the taxpayer not allocated under the definition of non-business income other than:
 - i. Dividends.
 - ii. Interest on United States, state or political subdivision obligations.
 - iii. Gross receipts received from the sale, redemption, maturity or exchange of securities. Exception: Proceeds from the sale of securities held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business. Securities held by a security dealer for own purposes would not be in factor.
 - iv. Gains on certain government obligations are considered securities and excluded.



- a. Sales of tangible personal property are assigned on a destination basis
 - i. Statutory Guidance - 72 P.S. § 7401(3)2.(a)(16)
 - ii. Regulatory Guidance - 61 Pa. Code § 153.26.(b)
 - iii. Sales from the rental, lease or licensing of tangible personal property are in Pennsylvania if the customer first obtained possession of the tangible personal property in Pennsylvania. If the tangible personal property is subsequently taken out of Pennsylvania, the taxpayer may use a reasonably determined estimate of Pennsylvania usage to determine the portion of the sale to allocate to Pennsylvania.
 - iv. The sale is assigned to Pennsylvania if the final destination of property is delivered or shipped to a purchaser within Pennsylvania
 - v. Dock sales
 - 1) All sales are sourced based on destination, regardless of how the goods are transported.
 - 2) Sales to purchasers who pick up the goods at the taxpayer's location and transport the goods to a location in PA are PA sales, regardless of the taxpayer's location. These sales are included in the numerator.
 - 3) Sales to purchasers who pick up the goods at the taxpayer's location and transport the goods to a location outside of PA are sourced outside of the Commonwealth, regardless of the taxpayer's location. These sales are not included in the numerator.
 - 4) Taxpayer must be able to provide documentation sufficient to establish an out-of-state sale.
 - a) Documentation sufficient to establish an out-of-state sale includes:
 - i) Bills of Lading of the carrier establishing that the goods were destined for or delivered to an out of state location.
 - ii) Delivery instructions from the purchaser to the carrier establishing that the goods were to be transported out of Pennsylvania.
 - iii) Warehouse receipts of the purchaser showing that the goods were delivered to an out of state location.
 - iv) Invoices issued by the taxpayer/seller to the purchaser showing an out-of-state delivery address.
 - b) Documentation which will be deemed insufficient to establish that the ultimate destination of goods to an out of a state location:
 - i) Invoices issued by the taxpayer/seller to the purchaser showing an out-of-state mailing address.
 - ii) Affidavits or other declarations from the seller, its employees or agents that the ultimate destination of goods was an out of state location.



- vi. Source documentation may include but is not limited to system generated sales reports, sales invoices, sales journals, data files (including data downloads), etc.
- b. Receipts other than the sale of tangible personal property
 - i. Statutory Guidance - 72 P.S. § 7401(3)2.(a)(16.1)(C)
 - ii. Sales on or after 1/1/2014 are sourced in the following manner:
 - 1) Sales from the sale of a service are in this state if the service is delivered to a location in this State. If the service is delivered both to a location in and outside this State, the sale is in this State based upon the percentage of total value of the service delivered to a location in this State
 - 2) If the state or states of assignment under #1 cannot be determined for a customer who is an individual that is not a sole proprietor, a service is deemed to be delivered at the customer's billing address.
 - 3) If the state or states of assignment under #1 cannot be determined for a customer, except for a customer under #2, a service is deemed to be delivered at the location from which the services were ordered in the customer's regular course of operations. If the location from which the services were ordered in the customer's regular course of operations cannot be determined, a service is deemed to be delivered at the customer's billing address.
 - 4) See Information Notice Corporation Taxes 2014-01
 - 5) For tax years beginning before January 1, 2014, the Department of Revenue viewed the location where "income producing activity was performed" as being where the benefit of the income producing activity was received. This position was upheld in Commonwealth Court Case *Synthes USA HQ, Inc., Petitioner v. Commonwealth of Pennsylvania* ___ A3d ___, 7/24/2020.

4. Interest Rents Royalties

- a. Interest (Statutory Guidance - 72 P.S. § 7401(3)2.(a)(7))
 - i. All interest will be sourced based on income producing activity as defined in Information Notice Corporation Taxes 2014-01.
- b. Rents
 - i. Rents from real estate and equipment are sourced to the location of the property.
 - ii. Mobile property should be based on a mileage basis.
 - iii. Airplane for corporate use assign by hanger days.
- c. Royalties
 - i. All royalties will be sourced based on income producing activity as defined in Information Notice Corporation Taxes 2014-01.



4. Gross Receipts from the Sale of Other Business Assets

- a. Real and tangible personal property – sourced based on location of property or destination.
- b. Intangible property – examples of intangibles that are included and assigned based on the income producing activity.
 - i. Industry intangibles (goodwill, trademarks, sale of technology or patents)
 - ii. Goodwill
 - iii. Futures – other than securities (net proceeds)
 - iv. Options
 - v. Foreign currency exchange contracts are included at net gains not proceeds.
 - vi. For guidance see Information Notice Corporation Taxes 2014-01 (Sourcing of Services) and Corporation Tax Bulletin 2019-01 (Hedging and Foreign Currency Transactions)
- c. Sales of partnership interest (applies to apportionment only)
 - i. A corporation's interest in a partnership is considered ownership of the underlying assets.
 - ii. When a corporation sells its interest in a partnership it is treated as a sale of the underlying assets, not a sale of an investment or intangible asset.
 - iii. The proceeds from the sale must be allocated to the types of assets considered sold by the corporation; securities, intangible assets, and real and tangible personal property. This is calculated as follows:
 - 1) Multiply the proceeds by the amount of securities reported on the balance sheet of the partnership divided by the total assets of the partnership. This is the amount of the proceeds received from the sale of securities and will be excluded from both the numerator and the denominator.
 - 2) Multiply the proceeds by the amount of intangible assets reported on the balance sheet of the partnership divided by the total assets of the partnership. This is included in the denominator of the sales factor as the sale of intangible assets. The amount sourced to PA is then determined as if the intangible were actually held by the corporation. If it is determined that an intangible is sourced to a particular state, the proceeds associated with the sale of that particular asset would be the proceeds allocated to the sale of intangible assets multiplied by the value of the that particular asset divided by the total intangible assets. Otherwise, the proceeds allocated to intangible assets are sourced on the income producing activity.



- 3) Multiply the proceeds by the amount of real and tangible personal property reported on the balance sheet of the partnership divided by the total assets of the partnership. This is included in the denominator of the sales factor as the sale of real and tangible personal property. The amount of the proceeds sourced to by PA is based on the percentage of the partnership's real and tangible property located in the state. This is done by multiplying the proceeds allocated to the sale of real and tangible personal property by the real and tangible personal property owned by the partnership in PA and divide by the total real and tangible personal property owned by the partnership.
5. Other Sales – Other income is categorized by type of income and assigned accordingly.
- a. Management fees
 - i. Prior to 1/1/2014 where customer receives the benefit
 - ii. On or after 1/1/2014 where service is delivered
 - iii. See Information Notice Corporation Taxes 2014-01
 - b. Scrap sales – situs
 - c. Sales tax discounts are includable in the factor, as this is a commission for timely filing and remitting of sales tax. Situs where return prepared
 - d. Bad debt recovery (receipts were originally included in prior period) and discounts (reduction in purchase price) are not receipt items and should not be included in the factor.
 - e. Rebates (return of money), either at the time of sale or mail in rebates are not included in the factor.
 - f. Refunds are not included in the factor. These are a return of the taxpayer's money that reduces expenses generated in a prior year. Examples include tax refunds, insurance refunds, and insurance dividends if actually a return of expenses).
 - g. Sale of Stock treated as a sale of assets under 26 U.S.C. 338(h)(10), (Canteen Corporation v. Commonwealth of PA, 818 A 2d 594 (PA Commonwealth 2003)).
 - i. Taxable years beginning after 12/31/98 - 338(h) deemed sales would be treated as business income. Gross proceeds from the sale would be in the sales factor.
 - ii. Taxable years beginning prior to 01/01/99 - 338(h) deemed sales would be non-business income. No proceeds would be in the sales factor.
 - h. Safe harbor leases (Regulatory Guidance - 61 Pa. Code 153.30).
 - i. Only when the real title rather than the tax title passes under Pennsylvania law from the seller/lessee to the purchaser/lessor will the transaction be given safe harbor treatment.
 - ii. If real title does not pass to the purchaser/lessor:
 - 1) The purchaser/lessor will not include the rental or interest income attributable to the safe harbor agreement in the factor.



- 2) The seller/lessee will not include the down payment or the installment payment relating to the safe harbor lease transaction in the factor.
 - iii. If real title does pass to the purchaser/lessor:
 - 1) The purchaser/lessor will include in the factor all rental or interest income attributable to such property.
 - 2) The seller/lessee will include in the factor the down payment and all installment payments attributable to the safe harbor agreement.
 - iv. Review Federal M-1s for safe harbor lease adjustments.
6. Partner's Share of Sale from Partnership – any underlying unincorporated entities
 - a. Statutory Guidance - 72 P.S. § 7402.2
 - b. Regulatory Guidance - 61 Pa. Code § 153.29
 - c. Partnership/joint venture sales.
 - i. Interest in an unincorporated entity (partnership, joint venture or similar association) shall be considered a direct ownership interest in the assets of the underlying unincorporated entity. The “corporate” owner should include the proportionate share based on capital ownership as reflected on the Schedule K-1 of the underlying entity’s sales factor for corporate net income tax and capital stock/franchise tax if applicable.
 - ii. Partnership Agreement – Used to determine the taxpayer’s partnership interest when computing the sales factor. The taxpayer shall provide a copy of the partnerships FF1065, Schedule K-1 and a by-state breakdown of sales.
 - iii. The appellate courts upheld that interest in an unincorporated entity is considered a direct ownership interest in the assets of the entity and that the gain from the sale of such assets is considered business income (RB Alden Corp v. Commonwealth of PA, 142 A.3d 169 (PA Commonwealth 2016))
 - iv. The corporation’s distributive share of income/loss (usually reported on page 1, line 10 - other income on the Federal Form 1120) is excluded for factor purposes.
 - d. LLCs/business trusts.
 - i. The proportionate share of the underlying LLC/business trust’s (if not classified federally as a corporation) sales will be included in the corporate owner’s corporate net income sales factor. The proportionate share is based on capital ownership as reflected on the Schedule K-1. The proportionate share of the LLC/business trust’s sales factor is not included in the corporate owner’s capital stock/foreign franchise sales factor because the LLC/business trust is statutorily classified as a corporation and would report for capital stock/foreign franchise on its own activity.
 - ii. If the underlying LLC/business trust is classified federally as a corporation, the proportionate share of the sales factor is not included in the corporate owner’s sales factor.



- e. Intercompany sales between taxpayer and partnership interest.
 - i. Sales between the partnership and the taxpayer shall be eliminated from the denominator and numerator of the taxpayer's sales factor as follows:
 - 1) Sales by the taxpayer to the partnership to the extent of the interest in the partnership
 - 2) Sales by the partnership to the taxpayer not to exceed the taxpayer's interest in partnership sales.
 - ii. Sales made by the taxpayer or the partnership to non-partners shall be included in the taxpayer's sales factor in an amount equal to the taxpayer's interest in the partnership.
- 7. Synthetic Leases - The following table shows the difference between accounting for a "synthetic lease" for book purposes and tax purposes. Company A maintains legal title to the property in question.

	Company A Lessor	Company B Lessee
Financial Statement - Lease	Owns Property Expense Depreciation Reports Rental Income	Reports Rental Expense
Federal Income Tax - Financing Agreement	Reports Interest Income	Owns Property Depreciation Expense Reports Interest Expense
Nexus	Yes - holds legal title	Yes - using the property
Sales Apportionment	Interest income	n/a

8. Auditing Procedures

- a. Request source documents (including but not limited to by-state breakdown, general ledger, trial balance, system generated sales reports and/or downloads traceable to sales invoices)
 - i. Determine how the by state breakdown was prepared
 - ii. Trace back to original records.
 - iii. If no by-state breakdown and/or original records provided, determine in favor of the Commonwealth.
- b. Sales of tangible personal property – assigned on a destination basis.
 - i. A random check of sales records is required to determine if the taxpayer is properly reporting sales on a destination basis. Verify that sales are recorded using the shipping address and not the billing address.
 - ii. Trace the shipping address from the invoices to the destination sales reports to determine they are being properly reported
 - iii. Confirm that the destination sales reports include the destination of the goods on the sale from the taxpayer to its customer and not where the customer may resell it to a 3rd party.



- c. Sales of Services – for detailed guidance refer to Information Notice Corporation Taxes 2014-01 (Sourcing of Sales). This notice is intended to explain the Three Statutory Rules and show specific applications of each rule.
- d. Interest
 - i. If interest on United States, state or political subdivision obligations is in factor, remove it from the factor.
 - ii. Determine how interest income was earned (i.e., financing activities, bank accounts, loans, etc.)
 - iii. Verify interest was apportioned based on income producing activity. The location where the performance is fulfilled is the location of the income producing activity (see Information Notice Corporation Taxes 2014-01)
- e. Royalties
 - i. Determine how the royalty income was earned (i.e., patents, copyrights, trademarks, trade names, franchise fees, etc.)
 - ii. Verify royalties were apportioned based on income producing activity as described above and detailed in Information Notice Corporation Taxes 2014-01
- f. Sale of Other Assets
 - i. Verify to the FF4797, FF Schedule D or corresponding statements
 - ii. The figures should match the gross proceeds
 - iii. Verify where the property is located to determine if any portion is allocated to PA
 - iv. Sale of intangible assets will be reported at net or gross proceeds based on the type of intangible. Seek additional guidance from Headquarters.
- g. Other Sales
 - i. Review line item detail for specific income items.
 - ii. Exclude negative numbers from the factor
 - iii. Foreign Currency Exchange should be excluded for all tax years. See Corporation Tax Bulletin 2019-01 (Hedging and Foreign Currency Transactions)
- h. Partners Share of Sales from partnerships
 - i. Obtain partnerships federal return (FF1065) and by state apportionment schedules for all partnerships
 - ii. Compute taxpayer's distributive share of sales based on the taxpayer's percentage. Percentage of ownership is based off capital as reflected on the taxpayer's schedule K-1. If capital ownership percentage is changed during the year use a daily or monthly average.
 - iii. Obtain the Partnership Agreement if the partnership share is variable



- iv. The partnership's distribution of income to the corporation (usually reported on page 1, line 10 - other income on the Federal Form 1120) is excluded for factor purposes. Make sure that flow-through items are not included twice.
- v. Corporate Partners - Reporting of Partnership Activity.
 - 1) Sale of investment in partnership when the partner receives property rather than cash. This transaction does not affect the sales factor until the property received by the partner is sold.
 - 2) Taxpayer received distributions from the partnership above its basis in the partnership. The amount received above the basis is reported as a gain on the taxpayer's federal income tax return. This is considered a partial sale of underlying assets and the proceeds included in the sales factor in the same manner as a total liquidation.
 - 3) Distributions received from the partnership that change the partner's ownership percentage are not included in the sales factor.
- vi. All Limited Liability Company (LLC) sales must be listed on a sub-schedule. A sale of a multi-member LLC is treated the same as a sale of a partnership. A sale of a single member LLC is treated the same as a sale of assets.
- vii. Determine if there are any intercompany sales between related companies or partnerships.
 - 1) Ask the taxpayer for details on any intercompany transactions. Review the balance sheet to determine if there are any intercompany receivables or payables. Review sales records.
 - 2) Verify that on a separate company basis all intercompany sales were reported on the FF1120.
 - 3) For consolidated purposes, sales between members of the consolidated group are not reported until sold outside of the group.
 - 4) For separate company purposes, sales between members of the consolidated group are reported at the time of sale.
 - 5) For sales to a partnership or from a partnership by the taxpayer to the extent of the interest in the partnership is eliminated from the sales factor.

H. Special Apportionment

1. Railroad, truck, bus, airline, pipeline, natural gas and water transportation companies.
 - a. (Statutory Guidance - 72 P.S. §7401.(3)2.(b))
 - b. (Regulatory Guidance - 61 Pa. Code § 153.27)
 - c. Taxpayers cannot use sales factor apportionment.
 - d. Must be expressed in revenue miles, revenue cubic feet or whichever the appropriate measurement is.



- e. Internal Guidance confirms that the special apportionment formula used for rail, bus and air corporations must comply with the courts holding in *FedEx Ground Packaging Systems*, 898 A.2d 22 (Pa. Commw. Ct. 2006). The formula must be in compliant with the statute.
 - f. Internal Guidance confirms that the combined apportionment may be used
2. Satellite Television Service Providers (Statutory Guidance - 72 P.S. §7401.(3)2.(e) (1))
- a. The fraction is calculated using the value of equipment owned or rented and used by the taxpayer to generate, process or transmit satellite tv services.
3. If the taxpayer has two distinct activities, they may be entitled to use split apportionment as explained in *Buckeye Pipeline Company*, 689 A. 22 366 (Pa. Commw. Ct. 1997)



- I. Net Loss Deduction (Statutory Guidance - 72 P.S. §7401.(3)4.(c)(1))
(Regulatory Guidance - 61 Pa. Code § 153.15)

Taxable Year	Limitations	Carryover
	Deduction cannot exceed amount of loss or losses carried forward	
1998	\$1,000,000	20 taxable periods
1999-2006	\$2,000,000	20 taxable periods
2007-2008	Greater or 12.5% or \$3,000,000	20 taxable periods
2009	Greater of 15% or \$3,000,000	20 taxable periods
2010-2013	Greater of 20% or \$3,000,000	20 taxable periods
2014	Greater of 30% or \$4,000,000	20 taxable periods
2015-2016	Greater of 30% or \$5,000,000	20 taxable periods
2017	30%	20 taxable periods
2018	35%	20 taxable periods
2019 and thereafter	40%	20 taxable periods

1. Net Loss Schedule (RCT-103) – Taxpayers are required to complete the RCT-103 reflecting the net losses available to be used, what is used, and what is carried forward to the subsequent year.
2. How net losses are applied:
 - a. The net loss carried forward would be loss calculated after apportionment
 - b. The carryforward period for net losses are based on the starting date of the tax period
 - c. The net loss must be carried to the earliest taxable year in which it may be carried under this schedule.
 - d. There is no provision to forgo the use of a net loss in order to use a credit against the tax liability
 - e. Short periods are considered one taxable period



3. Federal Audits and Net Losses - When the result of the Report of Change affects the tax liability in a subsequent year that had been settled more than three years prior, and was not part of the federal audit, the Department has no authority to resettle the Corporate Net Income Tax for the closed periods. However, this does not prevent the Department from changing the application of the net losses in the closed years and initiating resettlement of the Corporate Net Income Tax for years which are still within the statutory resettlement period, or adjusting the net loss carried forward into an unsettled year, if appropriate

4. Change in Ownership

(Statutory Guidance - 72 P.S. § 7401(3)4.(g))

(Regulatory Guidance - 61 Pa. Code § 153.15.(e))

- a. Change in ownership by purchase, liquidation, acquisition of stock or reorganization of a corporation in the manner described in 26 U.S.C. § 381 or 26 U.S.C § 382, the limitations provided in the Internal Revenue Code with respect to net operating losses shall apply for the purpose of computing the portion of a net loss carryover recognized.
- b. Sale of Stock treated as sale of assets under 26 U.S.C. §338(h)(10)/ --Under this election the company is deemed to have sold all its assets in a complete liquidation under 26 U.S.C. § 381 and the net losses revert to the original parent company. This is consistent with the ruling in (Canteen Corporation v. Commonwealth of Pennsylvania, 818 A.2d 594 (Pa. Cmwlth. 2003)). In this case the court ruled that the Department must treat these transactions as a sale and distribution of assets in the calculation of Corporate Net Income Tax.
- c. To determine the portion of such deduction attributable to the net loss carryovers of the distributor or transferor corporation to the first taxable year of the acquiring corporation ending after the date of distribution or transfer shall be limited to an amount which bears the same ratio to the taxable income (determined without regard to a net operating loss deduction) of the acquiring corporation in such taxable year as the number of days in the taxable year after the date of distribution or transfer bears to the total number of days in the taxable year.
 - i. 'A' merges into 'B' during the year. In order to determine A's loss that would be able to be used during the year of merger:

of days from merger date

to the end of the year x PA Taxable Income

total days in the tax year

- ii. The rules for net loss carry-forward applicable to that date should be used and the statutory deduction limitations apply.
- d. When merging two or more corporations with different fiscal year ends the survivor will combine the net losses of the merging corporation with the net losses generated by the survivor based on the beginning of the merging corporation's fiscal year.



5. Net Losses and Limited Liability Companies (LLC)

- a. Unused net losses of an LLC that were incurred when the LLC was treated as a corporation subject to Pennsylvania corporate net income tax could not be claimed by its member in tax years after the LLC stopped being treated as a corporation. Pennsylvania law treating all LLCs as corporations was changed to conform to Pennsylvania's classification of an LLC to the entity's classification under federal law.
- b. If a corporation reorganizes into a single member LLC, disregarded for federal income purposes and whose member is a corporation as defined in Article IV of the Tax Reform Code of 1971, any Pennsylvania net losses generated by the entity prior to the reorganization may be used the member. For federal income tax purposes, the net operating losses in this situation belongs to the member under IRC Section 332.
- c. If a corporation reorganizes into a multi-member LLC any Pennsylvania net losses generated by the entity prior to the reorganization may not be used by any member. For federal income tax purposes, the LLC would either be a partnership or a corporation and the survival of the net losses depends on the nature and detail of the transaction.

J. Add-Back Credit for tax paid by Affiliate for Intangible Expense or Related Interest Expense.

1. When the taxpayer is engaged in one or more transactions with an affiliated entity that was subject to tax in this Commonwealth or another state or possession of the United States on a tax base that included the intangible expense or cost, or the interest expense or cost, paid, accrued or incurred by the taxpayer, the taxpayer shall receive a credit against tax due in this Commonwealth
2. The portion of tax paid by the affiliated entity is computed by multiplying the apportionment factor of the taxpayer in Pennsylvania by the greater of: 1) the tax liability of the affiliated entity with respect to the portion of its income representing the intangible expense or cost, or the interest expense or cost, paid, accrued or incurred by the taxpayer; or 2) the aforementioned tax liability before it was offset by a credit given by Pennsylvania or that state, except credits made for prepayments of tax
3. The taxpayer must complete REV-803, Schedule C-7 Credit for Tax Paid by Affiliated Entities.
4. The auditor must verify that the affiliated entity pays corporate income tax in a separate filing state, or separate filing state that allows consolidated filing (as opposed to combined filing) that is the commercial domicile of the affiliated entity, and tax is imposed on the intangible expense and related interest revenues earned by that entity, the transaction qualifies for the PPAL exception, and no credit should be computed for the transaction as it is already excepted by statute.
5. See Information Notice Corporation Taxes 2016-01 for examples



Appendix 1 – Corporate Net Income Tax Extras

1. REV-799 (Adjustment for Bonus Depreciation) - used for tax periods prior to 1/1/2018

A. Schedule C-3 Adjustment for Bonus Depreciation (REV-799) Used for property placed in service prior to 9/28/2017 – An ongoing historical reference for all bonus depreciation calculations

Column A – Tax Year End – four digit indicating year end

Column B – Fed. Depr. Section 168(k) Property – Equal to the amount of bonus depreciation plus the depreciation under normal rules.

Column C – Current Year Bonus Depreciation – Equal to the bonus depreciation addback from the FF4562.

Column D – Column B minus Column C – Calculation

Column E – Additional PA Depreciation – Calculation D time 3/7

- i. The calculation will recapture the full amount for assets that utilized 30% bonus depreciation. If the asset utilized 50% or 100% bonus depreciation a portion of the balance will remain unrecovered by the end of the asset life. The remaining balance must be calculated on Schedule C-4 for an additional deduction

Column F – Other Adj. Section 168(k) Property

- i. Used when the remaining bonus depreciation to be recovered is less than the current year 3/7 depreciation
- ii. The excess is subtracted when calculating total deduction

Column G – Adj. for Disposition of 168(k) Property – recover the remaining balance

- i. Property is disposed of during its useful life – applies to any 168(k) property (30%, 50% or 100%)
- ii. Property reaches the end of its useful life – applies to unrecovered balance for 50% or 100% property
- iii. Must complete Schedule C-4

Column H – Additional PA Depreciation Plus Adj. for Disposition – Calculation E minus F plus G

Column I – Balance – Calculation of prior year balance plus C minus H

B. Schedule C-4 Adjustment for Disposition & Recapture of Depreciation (REV-799) Used for property placed in service prior to 9/28/2017 – A one-time reference for bonus depreciation calculations in the current period

Column A – Tax Year End of Purchase – four-digit indicator for date the property was originally acquired

Column B – Federal Accumulated Depreciation – Total accumulated depreciation of disposed property



Column C – Disallowed Bonus Depreciation – bonus depreciation disallowed in the year of purchase

Column D – Column B minus Column C – calculation

Column E – Additional PA Depreciation – calculation (D times 3/7) of depreciation allowed between year of purchase and year prior to disposal.

Column F – Adjustment for Disposition – calculation C minus E. Amount carried to Schedule C-3

2. Sales Factor prior to 1/1/2014

A. Receipts from other than the sale of tangible personal property

i. Sales other than sales of tangible personal property, are in this state if:

- 1) The income-producing activity is performed in this state; or
- 2) The income-producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance. (Statutory Guidance 72 P.S. § 7401(3)(2)(a)(17))
- 3) It is DOR policy is that the income-producing activity is sourced to where the customer receives the benefit of the transaction and not where the taxpayer completes the transaction.